

Principles for Ethical Equity Investing in Microfinance Institutions

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EXECUTIVE SUMMARY

Introduction

The purpose of this Policy Analysis Exercise is to identify and create consensus around core issues for inclusion in a Principles of Ethical Investing (Principles) document for the Council of Microfinance Equity Funds (CMEF). We have generated a set of recommended concepts for inclusion in the CMEF document. These represent a consolidation of input from CMEF members, Microfinance Institution (MFI) managers, MFI clients and industry associations. We also present recommendations related to the appropriate structure of the document, negotiation strategy, ratification process, continued stakeholder engagement, disclosure, and compliance.

Research and Findings

We identified essential components for a Principles document through a three-part process: a) analysis of relevant literature b) iterated interviews with equity investor members of CMEF and c) interviews with MFI management, MFI clients, regulators and trade associations in South Africa and Bolivia.

Our key findings for critical Principles components amongst CMEF members include a) transparency, b) governance, c) managing conflicts of interest, d) creating greater collaboration in the sector and e) ratification. Within these broad categories, we identified further sub-categories that are essential to ethical investing. These concepts also garnered widespread consensus amongst other key stakeholders.

Recommendations

Our recommendations are as follows:

- I. Adopt Principles-based Model
- II. Employ Negotiation Strategy to Achieve Ratification
- III. Continue Non-CMEF Stakeholder Engagement
- IV. Increase CMEF Independence
- V. Create an Independent Source of Deal Data
- VI. Employ Compliance Mechanisms

INTRODUCTION AND BACKGROUND

COMMERCIAL MICROFINANCE EQUITY SNAPSHOT

- *In 2006, 222 candidates for equity investment – up from 124 in 2004. (According to this data source, candidates for equity investment are defined as regulated, commercial, shareholder-owned institutions)*
- *Commercial MFIs = \$1.5 billion of total equity, \$9 billion loans outstanding, \$14 billion in assets*
- *Roughly 11.5 million clients reached by these candidates – up from 3 million in 2004*
- *More than \$435 million in additional equity added between 2004-2006 alone – generated from retained earnings and new investment.*
- *During 2004-2006, 'Top tier' commercial MFIs achieved (annually): 70 % asset growth, 49 % equity growth, and 31 % growth in # of clients served.*
- *CMEF members made total combined investment of \$144 million as of 2006.*
- *Future: External equity financing projected to top \$500 million by 2010.*

All data in this section from: Rhyne, E. & Busch, B., "The Growth of Commercial Microfinance: 2004 - 2006. Council of Microfinance Equity Funds," (2006).

Microfinance is an important and rapidly expanding sub-sector in the field of international development. As part of industry-wide efforts to expand outreach, millions of dollars attracted from the capital markets are being used to purchase equity stakes in MFIs. Just 15 years ago, such equity investment in MFIs was not possible due to the un-regulated status of MFIs. By 2006, there were 222 regulated MFIs (potential candidates for equity investment) - almost double the count of just two years prior.

These institutions represent combined total equity of over \$1.5 billion¹. As the size and number of such equity holdings increases, MFI management comes under increasing pressure from investors to deliver attractive returns. Meanwhile, clients on the ground level are increasingly trusting MFIs to act in their best interest to offer deposit, savings, insurance and other financial services. While MFIs welcome the expanded pool of resources afforded them by the capital markets, they find that at times their mission and incentives do not correspond perfectly with those of equity investors. In order for the capital markets to foster the development of the industry while doing no harm to clients, microfinance equity investors must balance desire for high returns with dedication to social goals.

The Client and the Task

In 2004, an organization called the Council of Microfinance Equity Funds (CMEF) brought together many of the leading private entities making equity investments in MFIs in the developing world. According to the CMEF website, "in order to be a member, an organization must be a private institution, seek both financial and social returns in microfinance investment, and hold more than one equity investment in microfinance."² Our PAE client, ACCION

International, is “a private, nonprofit organization with the mission of giving people the financial tools they need – microenterprise loans, business training and other financial services – to work their way out of poverty.”³ ACCION serves as Council Coordinator for CMEF. Along with two other CMEF members in a recently-formed working group, ACCION International is leading an effort to create consensus on key elements of ethical practice in MFI equity investment. While the product of this work will only apply to CMEF members initially, it is likely to set the tone for industry-wide standards.

The central question that ACCION International would like to answer is:



What constitutes a set of acceptable and effective principles of
investing for equity investors in MFIs?



Two important related questions are central to our work: 1) how can ACCION effectively involve key stakeholders in the process and ensure the buy-in of Council members? and 2) how can ACCION ensure the compliance of Council Members going forward? Answers to these questions are critical if the Principles are to be meaningful to the industry, subscribed to by its core constituency, and embedded in the processes of each investor's transactions.

METHODOLOGY

To ensure that our recommendations are valuable to ACCION and CMEF, we employed a Delphi process – conducting interviews with several CMEF members and other stakeholders to understand their experiences in the equity investing processes and level of commitment to a widely applicable document of Principles. Prior to commencing the Delphi process, we conducted a literature review to provide industry context, explore alternative self-regulatory models, inform our process of stakeholder engagement and our analysis of disclosure and compliance.

Implementing the Delphi process involved two rounds of long-distance interviews and two international trips. During the first interview round we spoke to key CMEF members using an open-ended set of questions and established a list of core issues to address in the Principles. In a second long-distance round, we widened the pool of interviewees to include more CMEF members, policy makers and industry experts. To solicit their feedback we utilized an excel-based survey of 30 questions. Two international trips, to Bolivia and South Africa, allowed us to include input from MFI management, local MFI board members, MFI clients, regulators, and local industry associations. Importantly to the Delphi process, we included first round interviewees as second round survey recipients. We used a standard set of questions to guide our interviews with each stakeholder group in Bolivia and South Africa. After careful analysis, we turned feedback from all rounds of interviews into recommendations in five categories: transparency, governance, relationships, collaboration and processes. Please refer to the Bibliography for a list of individuals interviewed and Appendices 1, 2 and 3 for the questions/instruments used to solicit their input.

LIMITATIONS

Our research on the subjects of regulation, stakeholder engagement and disclosure is not exhaustive since the focus of the project was to generate a document of particular import to CMEF, rather than exploring these issues in depth. Since almost all of our contact with CMEF members was via telephone and email, we were not able to incorporate input from many CMEF members. Some of the feedback we received related to the survey used to solicit feedback in Round 2 indicated that the instrument was not intuitive and the some of the questions were unclear. While our visits to South Africa and Bolivia allowed us to incorporate very valuable input from other key stakeholders, we recognize the limited conclusions that may be drawn while examining only two countries. Similarly, we recognize the small sample size of our client interviews and present their input based on its value as anecdotal evidence.

ANALYTICAL FINDINGS

Advantages of Self-Regulatory Model vs. Traditional Model

- *Efficiency – lower information costs by leveraging industry expertise*
- *Cost burden internalized – shouldered by industry instead of taxpayer*
- *Flexibility – both in revision process and in compliance*
- *Reach – impact often extends beyond member group*

Disadvantages of Self-Regulatory Model vs. Traditional Model

- *Compliance – difficult to enforce; potential conflict of interest*
- *Tendency to become ‘floor’ – rather than standards of excellence*
- *Visibility – difficult to achieve level of awareness crucial to compliance*

I. Self-Regulatory Models

Implicit in our work for ACCION and CMEF is a judgment that: 1) Inconsistencies in regulations governing microfinance equity investment among MFI countries leave some key issues unaddressed and; 2) At present, a self-regulatory model will be most effective in filling this gap. In an effort to provide context and justification for our recommendations, we explored the literature on self-regulation and drew some insights on the advantages and disadvantages of this model over traditional regulatory models. Following this analysis is a brief examination of two well-known examples of self-regulatory regimes – the UK Banking Code and the International Organization of Securities Commissions (IOSCO).

Proponents of self-regulation most often highlight the advantages of lower costs and greater flexibility. Part of the cost-savings comes from reduced time spent by regulatory agencies and legislators learning about and discussing appropriate measures.⁴ Since

both of these parties – government agency employees and law makers – are likely to have little familiarity with the nuances of any given industry, self-regulation results in a more efficient deployment of resources in cases where the same impact may be achieved.⁵ Another important advantage is that in addition to the ‘information costs’ being lower in a self-regulatory model, these costs are internalized and therefore shouldered by the industry rather than by taxpayers.⁶

The advantage of greater flexibility (Codes of Conduct - or ‘Codes’ - are far easier to modify than formal legislation) is especially important in industries with volatile operating environments.⁷ Codes also give greater flexibility to

Examples

- *UK Banking Code – high specificity; rigid compliance system, ‘naming and shaming,’ annual reporting requirement signed by CEO.*
- *IOSCO – low specificity, CRAs must demonstrate incorporation of principles into internal Codes of Conduct.*

members in their approach to compliance and therefore make greater use of managerial skills and expertise than legislation.⁸ Finally, Codes often have an impact that extends beyond the group to which they officially apply. For example, the vast majority of banks & building societies in the UK eventually ended up subscribing to the UK Banking Code.⁹

“One of the main criticisms of self-regulatory codes of practice is that their provisions for monitoring, compliance and discipline are inadequate”

(Cartwright, P. (2004). [*Banks, Consumers, and Regulation*](#). Portland Oregon: Hart Publishing, pp. 131)

Perhaps the most common criticism of the model is that codes lack credibility and are not effective unless “there is the threat of legislation in the background.”¹⁰ Another criticism related to compliance is that it can be difficult for entities to serve simultaneously as regulators (sponsors of the Code) and as business people looking out for their own best interest.¹¹ Such conflicts of interest clearly jeopardize the effectiveness of self-regulatory codes.

Lack of visibility is yet another challenge often associated with codes. Cartwright points out that lack of awareness among direct beneficiaries weakens their contribution to the enforcement process and lessens the overall effectiveness of the Code.¹² He also suggests that Codes tend to be “lowest common denominator standards,” and “tend to provide a set of minimum standards rather than standards of excellence.”¹³

Following are brief summaries of two prominent examples of self-regulation which provide important insights for the creation of the CMEF Principles document.

The *UK Banking Code* is one of the most well known examples of effective self-regulation. The Code was drafted by relevant trade associations and included input from all relevant stakeholders – including the primary beneficiaries – consumers of financial services. Unlike many other Codes of Conduct, the *Banking Code* has a rigid compliance system – administered through the Banking Code Standards Board (BCSB). The BCSB Monitoring Team conducts inspections and compliance visits, accepts complaints, monitors media coverage of poor compliance and disciplines banks that fail to comply. Although the BCSB has various disciplinary tools at its disposal, it has no power to fine subscribers and relies instead on ‘naming and shaming.’ For their part, Banks each have a Code Compliance Officer that completes an annual self-certification questionnaire signed by the CEO.

Another prominent example of self-regulation is the International Organization of Securities Commissions’ (IOSCO) Code of Conduct Fundamentals for Credit Rating Agencies (Code Fundamentals). In this industry, Credit Rating Agencies (CRAs) are

formally regulated at local levels but generally “are subject to little formal regulation or oversight in most jurisdictions.”¹⁴ Like the *UK Banking Code*, the IOSCO Code Fundamentals incorporated input from a long list of stakeholder groups and the public at large. However, rather than being a rigid Code to be ratified by all IOSCO members, the 2004 Code Fundamentals actually serves as the foundation upon which members are to develop their own internal Code of Conduct. Owing to great variety amongst the structure and operating environment of the world’s CRAs, the IOSCO Code Fundamentals left significant room for CRAs to design their own unique implementation procedures. To encourage compliance, CRAs are asked to disclose how each provision of the Code Fundamentals is addressed in their own internal code and to justify any deviations

I. Stakeholder Engagement

Definition and Development

Stakeholder engagement is a process of relationship management that seeks to enhance understanding and alignment between companies and their stakeholders¹⁵. More generally, it is a way of connecting to those with an interest in the business of a company to gain information, support legitimacy, and create interest and align incentives between the company and stakeholders.

Stakeholders can be defined as “persons and organizations that affect, or are affected by, a corporation's actions--that is, all those that have a stake in what a firm does¹⁶.” Typically business has defined stakeholders narrowly as shareholders, and defined value narrowly as financial profit. This led to narrowly defined goals for the firm, and translated into business practices that could subject every other interest to that of increasing shareholder profit. Business acknowledged that these strategies were incomplete: they missed profit opportunities as well as contributing to situations that negatively affected a firm’s reputation, output, and future profitability. Stakeholder engagement theory grew out of two main principles: that business exists at the pleasure of society, and that business has a responsibility as a moral actor within society¹⁷. Theories about a firm’s function and responsibility in society, then, as well as pressure from outside sources, contributed to and supported the idea that became Corporate Social Responsibility (CSR). CSR involved the identification of more diverse categories of stakeholders, with differing and complex interests. This in turn necessitated an engagement strategy: a way to communicate and build relationships with stakeholders.

Stakeholder engagement as a strategy has emerged from stakeholder management, where stakeholders are thought of as subjects to be managed. Stakeholder engagement is network-based, relational, and process oriented, and mutuality, interdependence, and power¹⁸ in the company are shared in the stakeholder relationship. A successful

stakeholder relationship benefits both parties: the firm can gain from greater predictability of changes in the external environment resulting from better communications with external stakeholders (which may also lead to greater control); higher percentages of successful innovations resulting from the involvement of stakeholders in product / service design teams; and fewer incidents of damaging moves by stakeholders (e.g. strikes, boycotts, bad press) owing to improved relationships and greater trust¹⁹. Stakeholders in turn can gain from higher involvement and having more of their needs met.

"Industries undergoing rapid change have been frequent targets of Delphi research...there is a future for a whole family of Delphi-inspired techniques in a broad range of applications ...(which) will be the property of the market researcher, market planner, policy planner, systems researcher, as well as the long-term business planner."

Day, Lawrence H. "The Delphi Method: Techniques and Applications", Murray Turoff and Howard A. Linstone, 2002

Key processes for stakeholder engagement common across sectors and uses include identification, mapping, and ranking of stakeholders in terms of interest and power in relation to the company. Application of stakeholder engagement theory to the setting of CMEF and creation of a Code of Conduct requires extrapolation of key points from a situation that is markedly different in many ways. From the point of view of the Code, stakeholder engagement serves one purpose: to engage participants and future target institutions for the Code in the process, in order to obtain information and increase likelihood of compliance. Traditional stakeholder theory focuses instead on the role of business executives in including stakeholder concerns within business plans and processes, where stakeholders represent a diverse group

ranging from employees, to consumers, to neighbors of the physical facility. Thus a major concern of theory, which is the power relationship between those who create rules and strategy and those that are subject to their effects, does not exist within the Code framework. In this case the rules being made are unenforceable, and compliance depends largely on being able to attract independent actors to voluntarily adopt constraints. The value of theory that we apply to this process, then, is the underlying themes and related processes rather than specific frameworks.

- *Values.* Stakeholder engagement theory stresses the importance of relationship rather than management, and recognizing that the organization operates at the pleasure of its environment, and it has responsibilities relating to that place. We will build on these ideas in our approach to CMEF members, and in gaining knowledge of CMEF's and equity investment's place in the overall structure.

- *Processes.* Stakeholder engagement stresses identification, mapping, and ranking of stakeholder interests within its environment. We will identify key stakeholders within equity investment, and, where possible include these stakeholders in our engagement process.

Stakeholder engagement in international agreements

As discussed above, stakeholder engagement as defined in a corporate setting does not provide on its own an adequate framework for the process and goals of ACCION and CMEF. I present below two examples of international agreements, with similar goals, frameworks to those of ACCION / CMEF Principles, and look at the role of stakeholder engagement in these agreements' formulation.

Stakeholder engagement is key to institutionalizing Corporate Responsibility practices. Two examples of major agreements that formalized social responsibility into practice are Nestle's pledge to implement the WHO/UNICEF Code of Marketing of Breast-milk Substitutes, in 1984²⁰, and the UN Global Compact in 2000²¹.

The WHO/UNICEF International Code of Marketing of Breast-milk Substitutes was one of the first examples of a successful international code; in 1984 Nestle agreed formally to abide by this voluntary code²². The agreement, and Nestle's adoption involved a variety of stakeholders – transnational corporations, international organizations, and advocates from church groups, health workers, and political and consumer advocates. In this instance, stakeholders formed together around a targeted purpose and created a structure in which the targeted group's best interest was to comply.

The UN Global Compact, announced in an address by Kofi Annan in 1999, was adopted more quickly and has been broadly. The agreement's success is attributed to a coincidence of timing and political and social will behind it. The community for which it was destined was primed to accept it. According to one of its leaders, the Global Compact was put together without any idea of an overarching strategy of engagement²³.

These practices are similar to the introduction of codes of conduct in that they draw on the same ethical principles which they hope through utilization of methods introduced above to institutionalize into business practices (recognize triple bottom line). From their relative effectiveness, we can see three important factors in creating similar standards (for implementers): legitimacy, feasibility, and built in evaluation and monitoring capabilities.

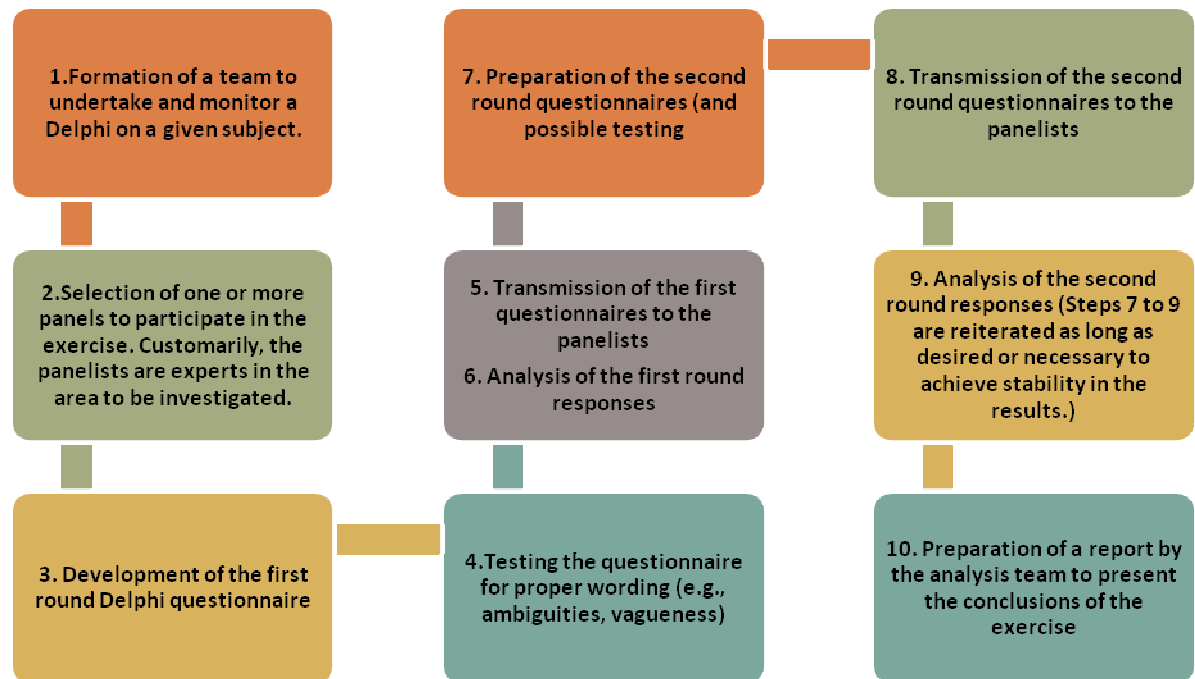
The Delphi Method

Research exposed the Delphi method as the most appropriate tool for stakeholder engagement, given the setting and distinction from the corporate environment. The

Delphi method has been applied successfully in government and business settings, and provides a tool for stakeholder engagement particularly well suited to the development of a trade association Principles of Conduct document.

The Delphi method is essentially an exercise of group communication among a panel of geographically dispersed experts²⁴. It was originally developed as a forecasting technique within the U.S. Department of Defense, and has since been applied in numerous corporate settings, including a study in the U. K. by the Hercules Powder Co. Ltd. on the future of the British Chemical Industry in the 1980s. In addition, Delphi has been used by: a "Glass" Company, a "Consumer Goods" Company, two "Chemical Companies," and an "Electrical Engineering" Company and that this is one of the most popular techniques of those companies utilizing technological forecasting methodologies²⁵. Anonymity, controlled feedback, and statistical response are its most important features, and those which experts find to be the most important in achieving its results. Comments, forecasts, and opinions are presented to the general group in the Delphi process without connection to their origin. This avoids skewed opinions and voting behavior that are often linked to a personality or position within a face-to-face meeting. And, because participants are able to revise feedback several times throughout the process, it is likely that the impression reviewers receive about their ideas is the correct one. Most importantly for the purposes of this CMEF initiative, Delphi usually has a high response rate: experts value the opportunity to participate and to provide information in the process.

Thus the key elements of Delphi are (1) structuring of information flow, (2) feedback to the participants, and (3) anonymity for the participants²⁶. The table below displays Fowles (1998) summary of ten (10) key steps related for the Delphi method:



The Delphi method leads to superior information regarding a specific topic, and higher interest from stakeholders (those who participated in the Delphi process). Careful implementation of two steps can greatly increase the chances of legitimate results from the Delphi process:

- *Identification of questionnaire recipients:* Experts should be chosen carefully based on their interest in, knowledge of and involvement in the subject which is being discussed – which are directly correlated with likelihood of response.
- *Questionnaire word choice:* Some of the biggest problems cited by Delphi critics involve the sensitivity of results to vague or ambiguous wording on the questionnaire. To some extent this will be corrected for through iteration, but vagueness from the beginning adds unnecessary steps to the process.

The Delphi process is a tested, structured method of stakeholder engagement which combines gaining information from experts with stakeholder buy-in and thus is appropriate for our purposes in identifying essential issues for a CMEF led Code of Conduct. We will apply the Delphi process to managing stakeholder engagement within the formation of the Code of Conduct. Steps will be as follows:

- *Identification of experts.* Within the pool of CMEF members, we will select a group that share to the greatest degree the following characteristics 1) have the highest interest in the area 2) have greatest expertise in a certain type of investment *or* diverse expertise in many investments 3) have the most time / ability to respond and 4) are likely to have views that are if not completely representative, are broad enough to include a wider interest than their own.

- *Creation and revision of questionnaires.* The first questionnaire to circulate by email will be general questions to elicit a general idea of interest, and so as not to guide questioning in one direction. It may also be sent to a smaller number of experts than will be included in subsequent rounds, though the recipients will be included in later rounds. Within revision of primary responses, we will look especially for areas of possible ambiguity and common themes of particular interest. Going back to literature on other successful Delphis will enrich this process.

Involving stakeholders in the formation of the Code ensures that stakeholders will be invested, will feel that their needs are being met, and increases likelihood of compliance. From the point of view of stakeholder engagement theory, identifying stakeholders, and mapping in relation to power, interest, and proximity will result in the most accurate information and highest possibility of success. Thus, for the Code of Conduct to be ratified and to assure maximum compliance, we will identify stakeholder engagement strategies, and used these ideas in combination with the Delphi process to create the Code.

II. Disclosure and Compliance

Transparency systems are government mandates that require corporations or other organizations to provide the public with factual information about their products and practices. Appropriately formulated and implemented, their results include the following: a) improving corporate governance, b) comparability and benchmarking capability, c) protection for relevant classes of users, d) the reduction of information asymmetries and e) it can give rise to the formation of standards, particularly for a newly formed industry.

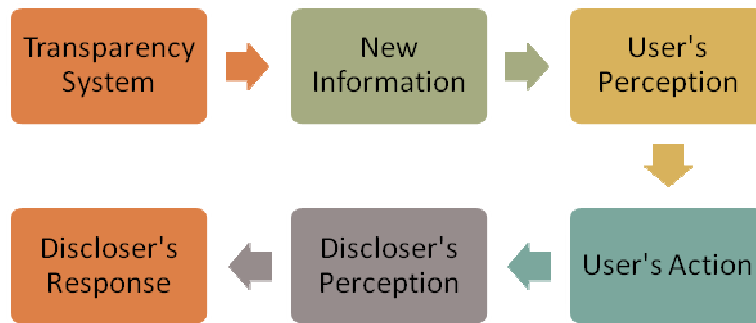
However, transparency systems, inevitably products of political compromise, can be constructed in a way that fails to advance policy goals. They can cause disclosers to over-emphasize some public goals at the expense of other, more important ones. They can confuse information users so their choices become counterproductive. They can be captured by narrow interests or grow outdated as markets and priorities change. Or they can simply waste resources when information that takes time and resources to produce is subsequently ignored²⁷.

In the case of public intervention, the benefit is that government mandated transparency systems are endowed with a legitimacy and accountability (since they are backed by a democratic mandate) that self-regulated entities or nongovernmental regulated bodies can lack. What then constitutes a relevant transparency system for a self-regulated, newly formed body such as the CMEF, which is only now discovering its own identity and testing its mandate? To analyze this, it is necessary to understand the conditions in

which disclosure can thrive and incentivize good behavior, and when it might lead to information in the public domain that does not optimally change behavior.

The Transparency Cycle

Disclosure essentially introduces new information into existing complex patterns of decision making by buyers and sellers and other participants in markets



or collective action processes. Their actions create incentives for information disclosers to improve their products and services. And such improvements in turn reduce risks to the public or result in fairer or more efficient services.²⁸ In a discussion with Professor Archon Fung of the Harvard Kennedy School, it was clear that to understand why disclosure works in some contexts and others, it is crucial to evaluate whether the information produced by disclosure policies are used in decision making and actions of information users and disclosers. The cycle which can be used to determine the effectiveness of disclosure systems is below²⁹.

The authors Fung, Graham and Weil show that there are essentially then three factors that influence the likelihood that information will become embedded in users' decision making: the information's perceived value in achieving users' goals; its compatibility with decision-making routines; and its comprehensibility. Finally the cost of acquiring information must be sufficiently low to justify users' efforts in relation to expected benefits. Disclosers on the other hand are more likely to incorporate user responses into their decisions if those responses have value in relation to discloser's goals, are compatible with the way they make decisions and prove comprehensible. The goals of disclosers are less likely than

"Disclosing information can clash with efforts to protect public safety and proprietary information, to guard personal privacy or to limit regulatory burdens. It can also clash with the central economic and political objectives of target organizations that may view such disclosure as a threat to reputation, markets or political influence."

Fung, Graham and Weil, "The Political Economy of Transparency: What makes Disclosure Policies Sustainable"

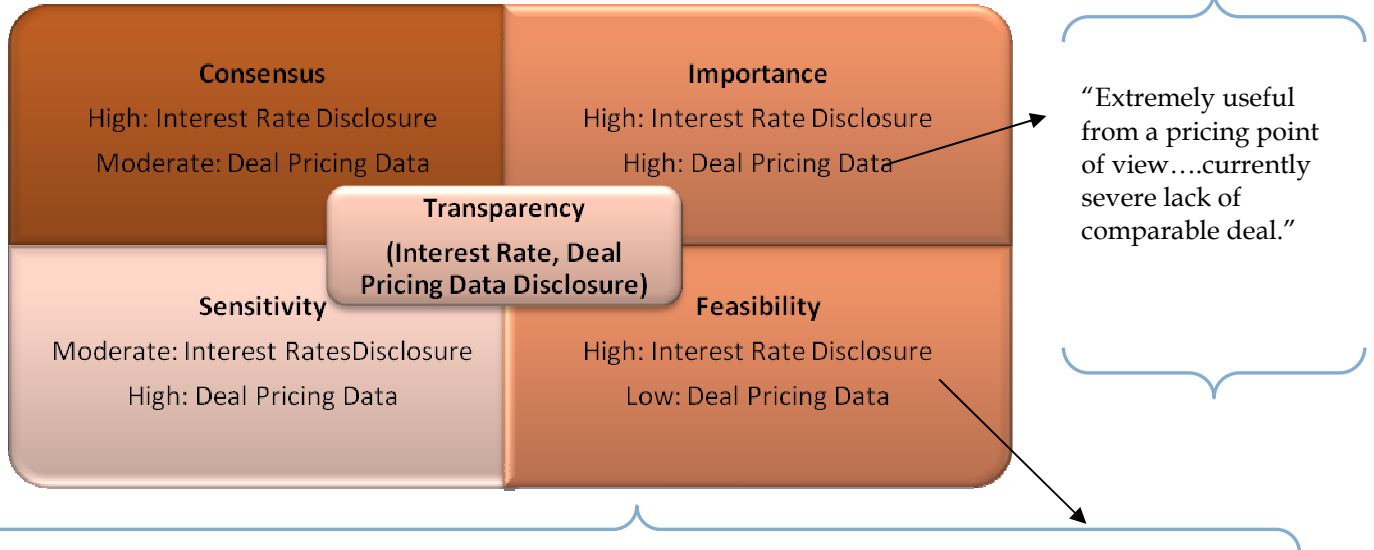
those of users to be congruent with the goal of disclosure policies. But that is not a major concern: it is only important the policy goals are congruent with the actions of users and disclosers.

Finally the issue remains whether disclosure policies should allow wide latitude in responses by disclosers, or whether they should be strict standards based policies that send unambiguous signals.

In conclusion, there is a wide literature on the effectiveness and ineffectiveness of certain disclosure policies, from nutritional labeling, to environmental carbon emissions disclosure, to restaurant hygiene, to SEC mandated disclosure. Disclosure cannot perfectly align the incentives of users and disclosers, and nor should that be its goals. Neither can it eradicate completely any existing information asymmetries. Furthermore, it must be an iterative process whereby regulatory agencies are continually learning about the incentives and actions of users and disclosers. As the authors say, transparency systems, always imperfect political compromises, must improve over time in scope, accuracy, and use in order to be sustainable³⁰.

STAKEHOLDER FINDINGS: CMEF MEMBERS

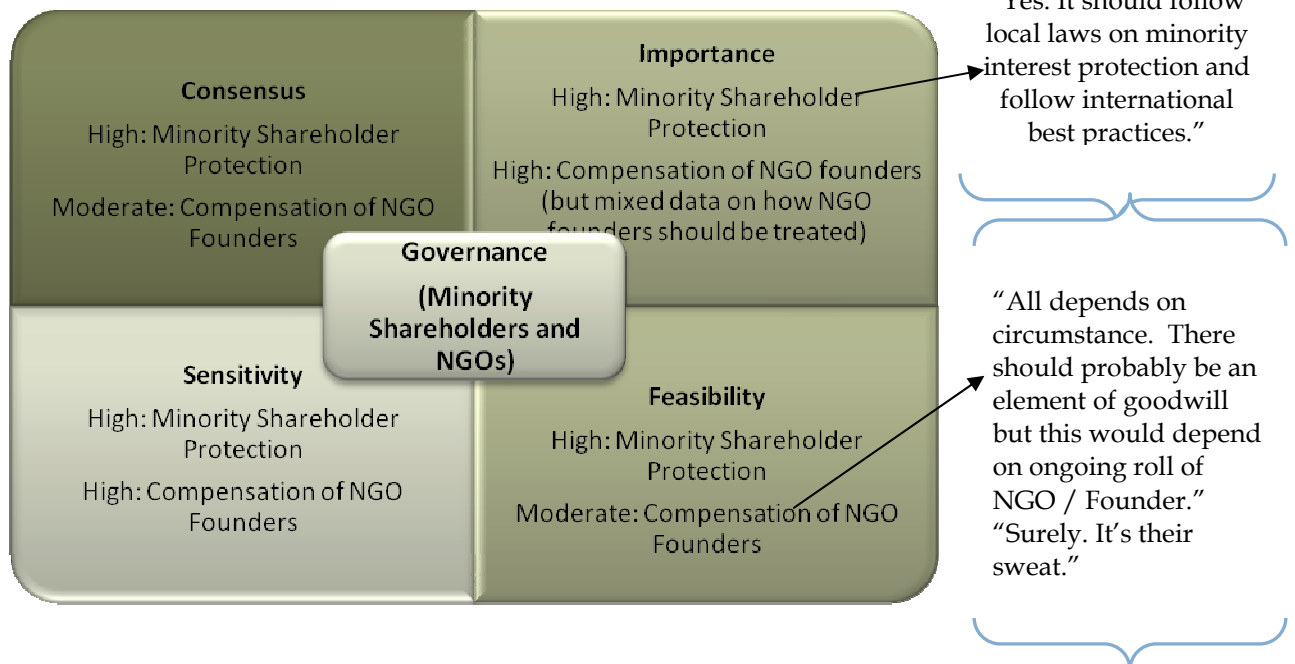
I. Transparency



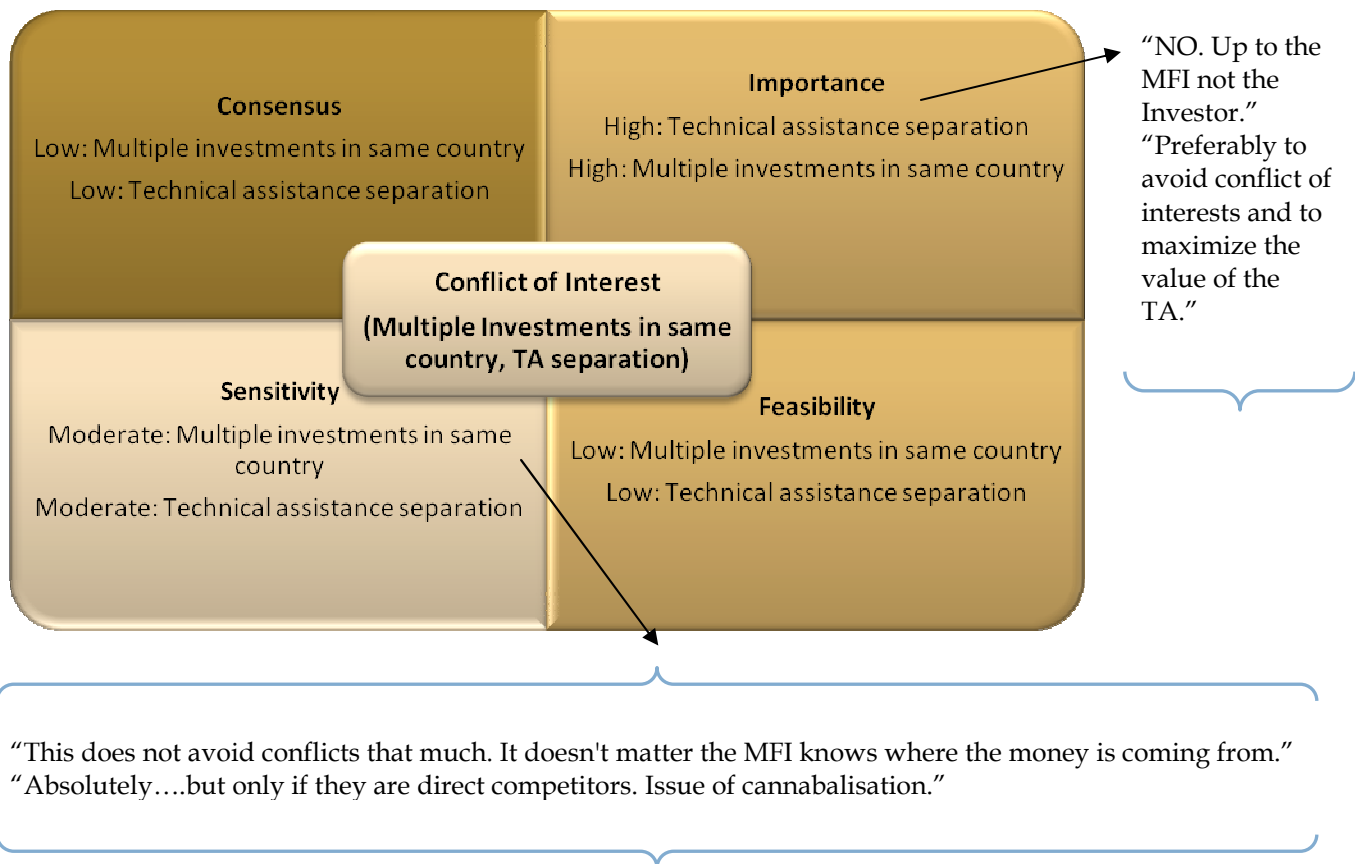
“Who is the audience? It does not really help clients to do so as they don’t understand the term, and could damage the MFI competitively if it is not compulsory for all MFIs in the market.”

“Pricing is sensitive and though clients fully understand it, it is important for MFIs to be transparent.”

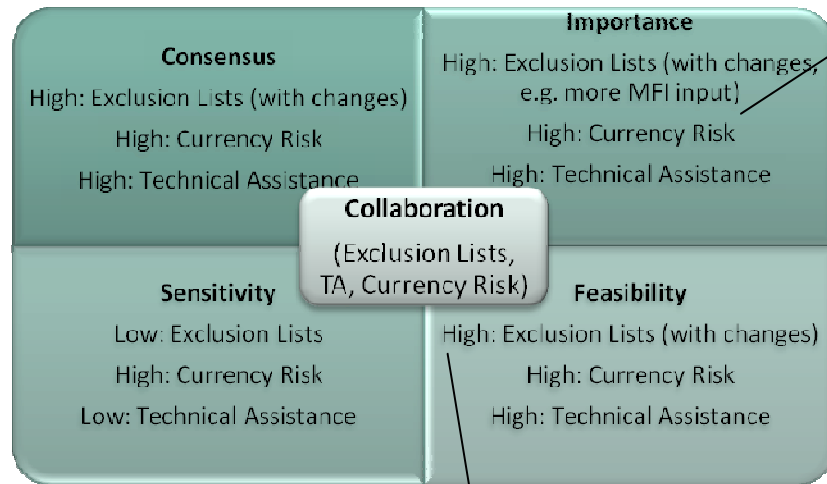
II. Governance



III. Conflict of Interest



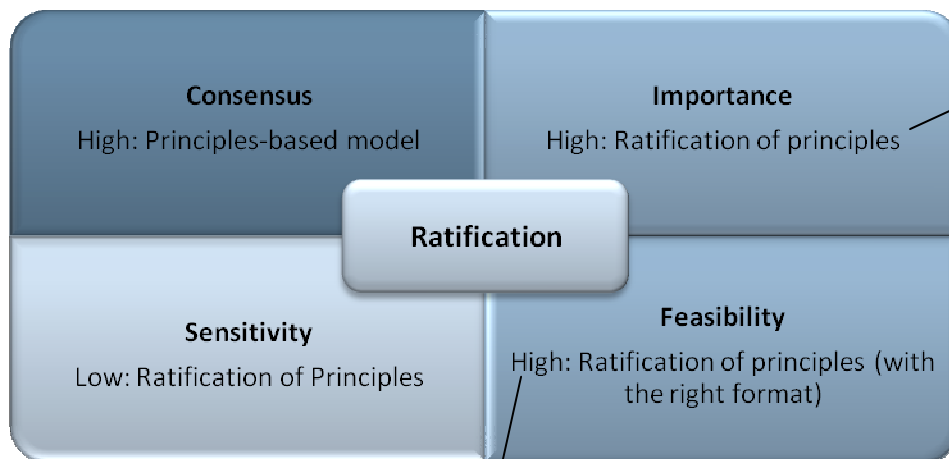
IV. Collaboration



“Depends. As a social investor, YES as local currency investing is more beneficial for MFI (less risk).”
 “Yes they should. They are better equipped.”

“Institutional investors such as the IFC or the bilaterals such as FMO or the Nordics--FinFund, NorFund, SwedFund are large institutions and have such requirements on the environment and child labor for all of their investments. This presents a real dilemma for MFIs and their clients, as the typical informal business that constitutes the borrowers use their children regularly as part of the business.”

V. Ratification

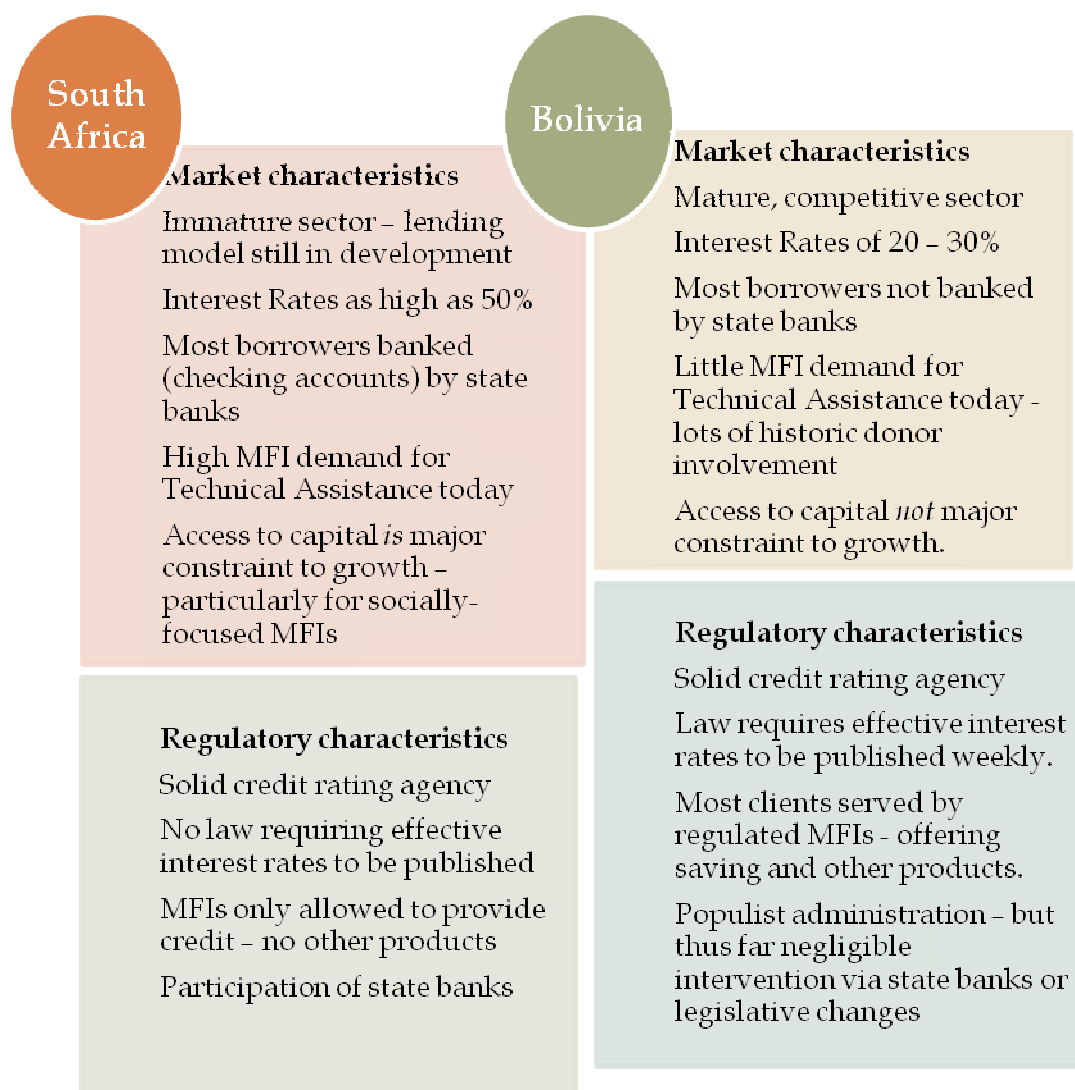


“Yes....good investment principles that promote development environment and an efficient market.”
 “More efficient investing and ultimately better development of industry.”

“Improves the image and quality of MF Equity funds.”
 “It is a good idea for the industry as it commercializes.”

STAKEHOLDER FINDINGS: IN-COUNTRY RESEARCH

I. Country Comparison



II. Findings from Microfinance Institutions

South Africa

MFI Type: Single and double bottom-line microfinance providers in South Africa including African Bank, Marang, Opportunity Finance, and Small Enterprise Foundation.

- **Capital Constraint:** Consensus that capital is major constraint on business and diversification of services. Particularly constraining in MFIs that are developmentally focused such as Marang and Small Enterprise Foundation (SEF).
- **Apprehension Over Foreign Investors:** Mainly attributed to:
 - Concern over little appreciation for vagaries and unique aspects of operating environment
 - Perception that investors with experience in Latin America hold on to misconceptions about supply and demand in South African market
 - Misperceptions among investors that operating costs should be lower due to low cost of capital (12.5%)
- **Interest Rates:** Conflict between investors and MFIs over interest rates (average = 50%). MFIs embrace double bottom line but high default and imperfect lending model necessitate high rates. Apprehension about possibility of 1) sparking price war by lowering rates (state banks would win) 2) sub-prime lending in search of higher margins.
- **TA:** Need for technical assistance (TA) and capacity building – particularly in rural outreach. Investors might help connect MFIs with NGOs to cover cost of TA.
- **Transparency:** Need for greater transparency on part of investors on two accounts:
 - Deal data – MFIs and investors called for transparency in pricing to help benchmark and postulated this would bring efficiency gains in the sector.
 - Investor motives / time horizon – most important during deal-shopping phase.
- **Flexibility:** Call for less restriction from investors – particularly with regards to other investors – this represented a very real constraint on increasing capital for these MFIs.

Bolivia

MFI Types: CEOs, former and current senior managers, and La Paz-based Directors of 3 high profile regulated MFIs: FIE, BancoSol, Ecofuturo, and one NGO: Crecer.

- **Board Meeting Attendance:** One MFI cited as very problematic the fact that ‘alternate’ board members don’t always communicate effectively with the ‘primary’ board members they replace on occasion.
- **Period of Exclusivity:** All but one strongly opposed this.
- **Exiting:** 3 out of 4 reported investors trying to influence selection of additional investors – but that this is not problematic. None required a put option.

- **Exclusion Lists:** Managers actually stated that they support exclusion lists – as long as investors are realistic about what can and cannot be monitored. All agreed that they would benefit greatly from more unified / streamlined reporting requirements.
- **MFI Code of Conduct:** Consensus that investors should require MFIs to have internal Code of Conduct. All MFIs have one. None share it with clients.
- **Disclosure:** No problems getting investors to disclose sufficient information.
- **Interest Rates:** All are required by law to publish effective interest rates.
- **CMEF Model:** Although one was in favor of more specificity, general consensus that most effective to use general principles. All interested in receiving copy of final product.
- **Publicizing Principles:** One highlighted the importance that all MFIs are aware the CMEF Principles exist and that CMEF should publicize it at a major conference.
- **Minority Shareholders:** No consensus on how minority shareholders are treated – in some cases they are given lots of voice, in others they are forced to accept decisions of majority holders.
- **Technical Assistance:** None still receive significant technical assistance – but all did previously. One manager stated that investors should be careful not to call “joint venture work” technical assistance. If the intention is for the investor to extract lessons about what works and what does not, than it should not be called technical assistance.

III. Findings from Microfinance Clients

South Africa

Client Type: Borrowers of Opportunity Finance, a 100% owned microfinance provider of Opportunity International in Pietermaritzburg, South Africa.

- Lack of access to credit: Most clients denied access by state bank (where they hold checking account) either due to lack of credit history or lack of verifiable income.
- Accessibility: frequent problems with branch location and also friendliness of service.
- High interest rates – but borrowers largely aware of entire cost of debt – and alternatives at competitors. South African MFIs are only allowed to offer credit as yet.

- Desire for capacity building - particularly with financial skill building.

Bolivia

Client Type: 18 clients from FIE, BancoSol, Ecofuturo - all in La Paz metropolitan region. Mostly veteran clients: Longevity with MFI: Range 3 - 23 yrs; Average = 11 years

- Almost no knowledge of foreign investors.
- Consensus that service / products had improved in recent years.
- 66% know their interest rate for credit.
- 20% of those with a savings product (10) know their savings interest rate.
- Mixed response about where to find interest rate info. Most common response was 'branch office,' followed by 'loan officer,' 'contract,' 'I don't know,' 'phone' (1), 'newspaper' (1), and 'internet' (1).
- Mix of responses to questions about 'what you'd most like to change.' Most common response was 'nothing,' followed by 'speed of credit,' 'interest rate,' 'service,' 'location of branches,' and 'flexibility with veteran clients.'

IV. Findings from Regulators

South Africa

Regulator Interviewee: Former Representative of the National Credit Regulator (now with FinMark Trust)

- Extensive regulation on the provision of credit - from a series of structured interest rate and fee caps, to extensive credit information, including a National Loans Register to detailed know your customer guidelines.
- Little has been done to promote developmentally-focused credit lending such as lending to micro enterprises or small businesses, particularly in the rural sector.
- He suggested CMEF Principles could help in suggesting investors could be more attuned to those needs.
- Enthusiastic and interest in obtaining CMEF Principles document when/if ratified.

Bolivia

Regulator Interviewees: Superintendent of Banks and 2 of his staff; Former Superintendent of Pensions, Insurance and Stocks and 2 other former staff: Former head of Bolivian Central Bank

- Interest in publishing CMEF document on their website
- Most elements covered by current law – exceptions: Governance and Conflicts of Interest
- Exclusion Lists play important role – but MFI input and understanding of context vital.
- MFIs should translate internal Code into concrete policies and publish for clients.
- One suggestion for CMEF members to mandate Independent Director quota.

V. *Findings from Trade Associations*

South Africa

MFSA: Microfinance South Africa Association (MFSA), a trade association of approximately 150 MFIs, and the FinMark Trust, a credit advocacy group

- MFSA acknowledged a need for capital in the sector, but were reticent about the need for foreign investors, as microfinance is a thriving business in South Africa and will likely attract equity from South African investors.
- FinMark Trust is a credit advocacy group made up of staff that were primarily with the regulator prior. Their mission is to make financial markets work for the poor, and is a DFID funded institution. They focus on how to increase access to financial services for the unbanked poor in Southern Africa.
- FinMark Trust acknowledged in particular the need for investors in NGO microfinance institutions in South Africa and also the need for technical capacity building by these investors in these NGOs.

Bolivia

Trade Association Interviewee: Executive Director of ASOFIN (Asociación de Entidades Financieras Especializadas en Micro Finanzas); Manager of Finances and Administration, Centro AFIN (Centro Internacional de Apoyo a las Innovaciones Financieras)

- ASOFIN's experience drafting 2005 "Declaration of Values and Principles" among 12 members suggests "Principles" model most effective for CMEF.
- Importance of compliance mechanisms in self-regulatory model.
- Important for industry to formally and publicly commit to principles such as these.
- Highlighted crucial role of Technical Assistance in development of Bolivian MF sector.

RECOMMENDATIONS

I. ADOPT PRINCIPLES-BASED MODEL

We recommend that ACCION and CMEF adopt a looser “Principles of Ethical Investing” model rather than that of a rigid Code of Conduct. As in the IOSCO example, this document will serve as the foundation upon which each member organization creates its own internal Code of Conduct. In this model each member organization will share its internal Code of Conduct with the group and highlight how all the elements of the “Principles” are addressed. This less rigid model accounts for the heterogeneity of CMEF membership, provides for flexibility in compliance, allows for more rapid ratification by CMEF, and accommodates ongoing discussion and revision.

II. EMPLOY NEGOTIATION STRATEGY TO ACHIEVE RATIFICATION

We recommend that ACCION and the CMEF working group focusing on this project employ standard negotiation fundamentals by circulating these “Principles” to a core group of members, including potential dissenters, prior to the semi-annual meeting in May. The objective in doing so is to ensure that there are enough members who are in favor of the “Principles” to begin and sustain an effective discussion. To formalize the process, a committee should be elected at the meeting to continue the process of stakeholder engagement. Additionally, we recommend that CMEF plan and launch a ratification process beginning at the May meeting. Key actors within CMEF (including participants in our survey process) will present principles outlined in this document to the larger group for discussion. Presentation during the meeting will allow for discussion of ideas within the CMEF and further engender buy-in from all CMEF members.

III. CONTINUE NON-CMEF STAKEHOLDER ENGAGEMENT

The efficacy and relevance of the Principles will largely depend on CMEF’s ability to communicate their purpose and substance to external stakeholders. We recommend a two-stage publication strategy: 1) ensure stakeholders are aware of the document when adopted and 2) ensure that stakeholder engagement takes place on an ongoing basis.

Short-term strategy: CMEF must begin as soon as the Principles are ratified to ensure a high level of awareness among MFIs, regulators and industry associations. The following recommendations incorporate both original ideas and input from interviewees.

- **MFIs:** Ideally, the document would be shared with all MFIs – regardless of their affiliation with a CMEF member. At a minimum, the document should be shared

by all CMEF members with current investees. If MFIs are willing, the document could be published on their website.

- **Regulators**: The document should be shared with regulators in all countries in which CMEF members hold investments and published on their websites. Bolivia's Superintendence of Banks has already expressed willingness to publish.
- **Industry Organizations**: The document should be published by all industry organizations – in both donor and MFI countries – and International Financial Institutions.
- **Conferences**: In order to increase awareness among all parties, the document should be presented by representatives of CMEF at a major conference – for example, the annual “Cracking the Capital Markets” conference.

Long-term strategy: The evolutionary nature of the industry dictates that CMEF members actively engage stakeholders in an ongoing dialogue about the Principles. This will help ensure accountability and establish legitimacy for members that adopt them. Since MFIs are the direct beneficiaries, they warrant special attention in developing a long-term strategy. We recommend that CMEF encourage MFIs to be more critical in judging investment opportunities, and strengthen accountability measures from investors to MFIs. Awareness of the Principles among MFIs and requests for greater transparency regarding investor motives and methods will ultimately aid in encouraging compliance. By empowering MFIs, CMEF will indirectly empower the ultimate end beneficiary – the clients.

IV. INCREASE CMEF INDEPENDENCE

As Council Coordinator of the CMEF, ACCION played a critical and foundational role in establishing the credibility of the organization. As CMEF matures, however, ACCION must be sensitive to perceptions that it has undue influence over the agenda and decisions of the group. We feel that CMEF will be more successful pursuing this and other initiatives if it is able to maximize a feeling of collective ownership amongst all its membership. Therefore, we recommend that CMEF form an independent office with at least one full-time staff. If budgetary constraints make this impossible, we recommend that the Principles document be housed by the current head of the CMEF working group. Irrespective of changes to the structure of CMEF as a whole, the current working group (headed by Erik Geurts of Triple Jump) should be formalized - a rotating chair should be elected and regular meetings scheduled. In this way CMEF can monitor progress and ensure that these Principles remain meaningful.

V. CREATE AN INDEPENDENT SOURCE OF DEAL DATA

We recommend that CMEF start an independent source of deal data. This suggestion could be on the agenda for the CMEF meeting in May. Disclosing pricing on certain key deals can set benchmarks for the sector and ultimately make it more efficient. One must

be cognizant of sensitivity issues on the part of investors. Instead of disclosing detailed valuation data and/or valuation principles, simple pricing - such as book value, revenue values etc. - can be disclosed. Ultimately, a certain group of investors needs to take the first step in publishing this data for the rest of the industry. Perhaps, if it is feasible, CMEF members can agree to disclose the data on a secure website accessible exclusively by members. This might also have the added effect of increasing membership in CMEF. One such suggestion is to feature such data on an existing MFI data platform such as mixmarket.org.

VI. *EMPLOY COMPLIANCE MECHANISMS*

A self-regulatory regime is only as good as its monitoring and compliance mechanisms. Following are recommendations to ensure members adhere to the Principles.

- **Internal Code of Conduct Submission:** Request that all CMEF members submit their internal Code of Conduct, signed by CEO, and demonstrate that Principles are incorporated.
- **Compliance Diagnostic Survey:** Create a Compliance Diagnostic Survey to help CMEF members assess level of compliance with Principles and measure progress toward full compliance. This survey could be modeled after that used by the Andean Development Corporation (CAF by its Spanish initials) to encourage compliance with the voluntary Andean Code of Corporate Governance. The CAF tool is a computer-based application which generates a compliance score based on 51 questions (for further detail see Appendix 6). Given limited resources, the CMEF survey would be far simpler.
- **Annual Submission of Survey Results:** While the results of the CAF survey are not shared externally, CMEF should consider asking members to share results of the survey annually to encourage compliance.
- **Compliance Targets:** CMEF should agree upon a timeline of compliance targets. For example, the group may agree that all members strive to reach:
 - 50% compliance in year 1
 - 75% compliance by year 3 and;
 - 100% compliance by year 5.

In addition to aiding monitoring and compliance, setting a gradual timeline will allow CMEF to more quickly reach consensus on the components of the principles - since members will not feel pressured to come into compliance immediately.



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APPENDICES

APPENDIX 1: CMEF Member Survey and Average Responses

APPENDIX 2: Minority and Majority Investment Case Studies

APPENDIX 3: List of Issues Used to Facilitate Round 1 Discussion

APPENDIX 4: Questions Used for South Africa and Bolivia Interviews

APPENDIX 5: Description of CAF Code Compliance Survey

I. APPENDIX 1: CMEF Member Survey and Average Responses

The table below presents results from CMEF member surveys. The colors indicate majority responses in ranking for each question. For “HIGH” a majority of respondents ranked the question with a 4 or a 5. For “MODERATE”, a majority responded with 3 or 4, and for “LOW” a majority marked 1, 2, or did not indicate a ranking³¹.

Ranking is necessarily subjective due to the relatively small pool of respondents. We feel that an average score, for example, does not represent a good cut-off, since it was clear from individual responses that rankings were relative to that individual’s internal scale – such that one respondent was much more likely to report 5s, while another only gave one or two 5 rankings across the survey. Thus we looked at high rankings within each survey (relative to how the individual ranked other answers) and compared these rankings across surveys.

It is important to view these rankings comprehensively as they indicate a central point to the study: many of the points which respondents considered to be the most important for a Code of Conduct or Principles to address are also highly sensitive, and can seem unfeasible. In deciding the elements to include in a final “Principles” document, how to present each, and what kind of compliance mechanisms to propose, it is absolutely necessary to enter with a complete understanding of the issues. It may be possible to leverage consensus on “importance” to address issues of sensitivity and feasibility within members.

Summary of CMEF responses

HIGH	HIGH	HIGH
MODERATE	MODERATE	MODERATE
LOW	LOW	LOW

		Importance	Feasibility	Sensitivity
1	Should MFIs publish their interest rate?			
2	Should MFIs publish transparent pricing on all their products?			
3	Should Investors publish Net Asset Values (NAVs) quarterly?			
4	Should details of ownership structures be published by MFIs?			
5	Would you be ready to publish your exclusion lists of unacceptable activities?			
6	Should investors homogenize their reporting requirements to MFIs?			
7	Should investors get more input from MFIs on subjects of exclusion lists?			
8	Should investors offer greater help in ensuring MFIs meet exclusion			
9	Should MFIs not force clients to take other products they offer, e.g. savings or shares?			
10	Should investors require MFIs to ask clients for basic identification?			
11	Should there be a period of exclusivity during deal shopping?			
12	Should investors tie technical assistance to either loans or share purchases?			
13	Should investors disclose their governance policies on all these questions?			
14	Should initial investors get veto power on future co-investors?			
15	Should investors restrict who MFIs can sell to down the line?			
16	Should technical assistance staff of an investor be separated from the investing staff?			
17	Should investors be careful of a conflict of interest in investing in the same country?			
18	How should independent external directors be treated on the board of an MFI?			
19	How should conflicts on strategy between investors on the board and CEO/NGOs on the board be handled?			
20	Would an independent source of deal data in MFI investing be useful?			
21	Should investors agree to disclose more valuation data than currently done? If so what should it include?			
22	Should investors protect NGOs and their founders as they transition to MFIs?			
23	Should investors take on currency risk themselves? (i.e. hedging the risk between lending in dollars and receiving income in local currency)			
24	Is protection of minority shareholders important? If so what form should it take?			
25	Should investors donate some form of technical assistance/capacity building to MFIs?			
26	Would you prefer a principles based model?			
27	Would you prefer a code of conduct?			
28	Would you be ready to publish the CMEF code of conduct (if any) on your website			
29	What is the best way of ratifying such principles of conduct?			
30	What is your interest in seeing such principles of conduct be ratified?			

II. APPENDIX 2: Minority and Majority Stake Case Study

The table below compares investments that constitute a minority and majority stake. We look here at the processes that make up an investment, including 1) what the investor looks for in an MFI 2) conditions of deal negotiation 3) what changes are made in the MFI as a result of the investment 4) how mission alignment plays a role in the investment process. We hope to find which differences emerge between the different types of investments. We had hoped to prepare more in-depth case studies of each investment, and to include a third type – minority stake with technical assistance – but were unable to obtain the information from the targeted investor.

	MAJORITY	MINORITY
Selection process: <i>general</i>	<ul style="list-style-type: none"> • Selection process depends on whether there are existing investments in the country. • Country level selection precedes investigation of a particular MFI. 	<ul style="list-style-type: none"> • Newly formed organizations • Positive track record that demonstrates possibility of an acceptable return on investment. • Preference for MFIs that originate from local initiatives.
Investment decision	<ul style="list-style-type: none"> • Majority stakes. • Analysis is made of all eligible MFIs at the country level. • Meetings with key players in the country: Central Bank, NGOs, donors and investors. 	<ul style="list-style-type: none"> • Willingness to agree on key issues regarding governance • Guarantee of a level playing field for all shareholders • Clearer separation of shareholder, Board, and management tasks
Criteria	N/A	<ul style="list-style-type: none"> • Seat on the Board • Minority stake together with likeminded partners • Reasonable return on investment • Recently starting MFI, with a positive track record
Selection process: <i>case specific</i>	<ul style="list-style-type: none"> • The investor had an existing relationship with a similar MFI in another country. 	<ul style="list-style-type: none"> • Organization was identified by MFI • Strong reputation from having made another loan: market knowledge and respect for local founders
Deal negotiation	<ul style="list-style-type: none"> • Investor made two initial visits and conducted many meetings to build relationships with the Board and staff of the MFI. • Investor also built on relationships made through the related investment. 	<ul style="list-style-type: none"> • Key issue: local vs. foreign control. • Local founders: fear losing control over operations. • Foreign shareholders: fear not enough input in key decisions. • Local founders resist formalization of decision-making procedures.

Governance: Treatment of Minority Stakeholders	<ul style="list-style-type: none"> • The investor has a majority of the Board. • Minority interests are brought into long-term ownership through a shareholders agreement. 	<ul style="list-style-type: none"> • Influence led to stricter and more professional reporting requirements for the management. • The investor wanted to include a board member appointed by minority shareholders and an independent board member.
Valuation	<ul style="list-style-type: none"> • The organization's standard is to pay no more than book value. • In the event that a premium is warranted, the investor looks at earnings and (sometimes) a DCF. 	<ul style="list-style-type: none"> • The investor creates the most likely future scenario for the MFI • Submits this model to different stress tests, • Gauges possible levels of return on investment.
Mission alignment	<ul style="list-style-type: none"> • The investee organization is one that can achieve the investor's goal of triple bottom line investment: sustainability, outreach in the country, and potential to transform lives, once part of the larger investor network. 	<ul style="list-style-type: none"> • It was better than its peers at adding new low income customers to the financial system • The MFI presented an alternative to other MFIs that were located in the economic center of the country
Role of regulation	<ul style="list-style-type: none"> • The licensing regime offers the choice of being a deposit-taking institution or full bank, • Capital requirements are reasonable. • The Central Bank was responsive in the process. 	<ul style="list-style-type: none"> • Regulation helped to push the organization towards a more formalized governance structure, specifically with clear separation of tasks between shareholders, board, and management.
Conditions for investment	<ul style="list-style-type: none"> • MFI must allow a change of ownership and management • The existing Chairman was removed in advance of the deal • The board was restructured • The MFI operates under a new license 	<ul style="list-style-type: none"> • An agreement on key governance principles • Increased professionalism of management, and a more formal decision making process.
Exit strategy	<ul style="list-style-type: none"> • The investor may divest if set goals are not achieved within three or four years 	<ul style="list-style-type: none"> • The investor believes the upside of its investments will provide an exit strategy in the future. • The only exiting provision was a drag-along clause in the shareholders agreement.
Lessons learned	<ul style="list-style-type: none"> • The performance of the MFI was negatively affected over the period of the investment, which was lengthened due to vendor delays in focusing on the transaction. Overall though, the experience was positive. 	<ul style="list-style-type: none"> • Tensions between locals and foreign shareholders and between management and the board led to new thinking and acting in the MFI, and proved very positive.

III. APPENDIX 3: List of Issues used to facilitate Round 1 discussions

- *Conflict of Interest:*
 - Sources:
 - Consulting (TA) and Investment relationships
 - Multiple investments in same country – divided loyalties
- *Transparency*
 - Need to assure that MFIs are being sufficiently transparent with pricing.
- *Exclusion Lists*
 - List of activities that MFIs should *not* to participate in – social and environmental in focus – EX: MFIs shouldn't lend to clients involved in manufacturing/selling non-beer alcoholic beverages, guns, tobacco, child labor (excluding family businesses)...
 - Includes “social and environmental policy system” – accountability component to demonstrate compliance; MFIs come up with policies and procedures, regularly check portfolio to ensure compliance, demand annual report from investees that outline exceptions / difficulties
 - Idea might be to set a standard for all members to comply with – consistency.
 - Homogenization of all requests made on MFIs is really important because complying with the unique requests of each funder / investor / donor becomes a huge burden on resources.
- *Process of Transformation from NGO to Regulated Institution*
 - It's difficult to value new MFIs. Questions:
 - How does the value get transferred from NGO (sort of public entity) to a private entity?
 - “Founder's Shares” - How much do managers get (and at what price?)
 - How much does NGO get – they still exist – so what % of the shares do they get?
 - When should the NGO phase out of regulated MFI ownership?
 - One problem is that NGO doesn't have income – so they can't back up an MFI during a financial crisis the way other investors could. If NGO retains 60% of shares, this could become problematic.
- *Past Due / Predatory Lending*
 - Consumer lending model – cut operating costs by allowing higher past-due portfolio (less diligence and chasing around) – this could hurt clients, because they actually can't afford these loans
 - Need to balance desire to scale up with keeping up quality of loan portfolio, making sure that loans are applicable to clients
 - Broad ethical issue of over-indebtedness

- Maybe for our purposes – we just say that investors require that all MFIs have Code of Ethical Lending / Consumer Protection Policy.
- *Protection of minority Stakeholders*
 - How are they treated, what status are they given?
- *Governance: Role of Directors of MFIs on Board*
 - Conflict of interest possible– b/c Director’s 1st priority is to organization – not to shareholders.
 - Mission vs. shareholder concerns
 - Maybe there should be a CMEF policy on this
- *Negotiation of Shareholder Agreement*
 - Often very long process
 - Document is roadmap of joint investment – all details of sharing responsibilities and returns, and potential growth...
 - Issue of “deal shopping”
 - Maybe should be articulation of how investors should handle the process
 - “period of exclusivity of negotiations”
 - (This may be tough to get into the code)
 - How pre-agreements are signed
 - When 2 or more international investors are working together, how do they behave when they don’t agree on a point – should they commit to not backing out?
- *Exiting*
 - Who you can sell to (co-investors often want veto power over who MFIs will be selling to down the road)
 - In order to get agreement, this would have to be REALLY general (ex: maintain good standards, uphold social mission)

IV. APPENDIX 4: Questions used for South Africa and Bolivia Interviews

MFI Management:

General:

1. What is the most difficult aspect of your relationship with equity investors and what would you change about it?

Governance

1. Do you have a “Statement of Rules and Expectations” for the Board?
2. Do investors on the board understand and support the mission of the MFI?
3. Has the entry of equity investors impacted in any way your mission?
4. Do Board members take too much of a short-term view? Do they take too much of a long-term view?
5. Are there conflicts between management and the board and? If so, how are these normally resolved?
6. How are independent directors treated on the board?
7. How are minority stakeholders treated on board?
8. Do Board members representing institutional investors change too often? Is this disruptive?
9. Who covers the travel costs of international board members attending meetings? Is this cost perceived as burdensome?

Conflict of Interest:

1. Do you have a ‘Conflict of Interest Policy’ in place?
2. Is the level of contact between board members and senior staff appropriate?
3. Is there a perception of a conflict of interest problem in the eyes of non-management employees?
4. Do any of your investors also invest in other MFIs in Bolivia? Do the same people sit on the boards of competitors? Is this problematic?
5. If you receive technical assistance (TA), are the TA staff completely separate from the investing team staff?

Disclosure:

1. During shopping – what do you want disclosed by investors before you decide to do the deal? – Like fund philosophy – double bottom line, role of board?

Lending practices / Interest Rates:

2. How do you communicate interest rates to clients?
3. Do you publish effective interest rates (taking into account obligatory savings...etc.)?
4. Are interest rates on savings and other products published or just for credit?
5. Do your credit products carry obligatory savings?
6. Do you require official forms of identification from clients?
7. Do most of your clients have official forms of identification?

Exclusion Lists:

1. Do any of your investors require Exclusion Lists?
2. If YES, do you think this is a fair arrangement?
3. If not, do you have an Exclusion List anyway?
4. How effective are you in implementing it and monitoring compliance?
5. What are fair standards for the list – what should be included?
6. Are reporting requirements for investors appropriate or are they burdensome on MFI?
7. Are reporting requirements for investors consistent?

MFI Code of Conduct :

1. Should investors require that MFIs have a Code of Ethical Lending – or Consumer Protection Policy?
2. Do you have one?
3. Where is your code of conduct published?
4. Are most clients aware of it?

Technical Assistance (TA):

1. Do you request TA from investors or is it bundled in with the capital?
2. Is the TA you receive donated or are you charged?
3. What kind of TA would you like that you are not getting?
4. Shareholder Agreement:
5. Should there be a “period of exclusivity of negotiations” during negotiations with investor?

Exiting:

1. Do investors normally try to have a say as to who else can invest in the future?
2. Do the investors want total freedom as to whom they will sell in the future?
3. Do they require a put option?
4. CMEF Code / Principles:
5. If CMEF were to create a Code/Principles of Conduct for Equity Investors in MFIs, would you find it useful to publish it locally - and if YES, where could investors publish it? Press Release?
6. What should such Code/principles contain?

Clients:

General:

1. Are you aware that your MFI has foreign investors?
2. Are you aware that your MFI has a Code of Conduct? (if applicable)
3. How many years have you been a client of your MFI?
4. Has the service that the MFI provides to you changed over last few years – better or worse?
5. What would you like to change about your MFI if you could?

6. What kind of info would you like from your MFI that you currently don't have?
7. Interest Rates:
8. Are you aware of your interest rate for loans?
9. Are you aware of your interest rate for savings and/or other products?
10. Do you know where to find information about your interest rates?

Regulators:

1. How did your organization design its current regulations? - Stakeholder engagement process?
2. What were the priority issues when they designed their regulations?
3. What are the current enforcement mechanisms?
4. What changes have they seen in the industry with entrance of more investors?
5. Is there a need for self-regulation among equity investors?
6. Would a Code/Principles of Conduct be effective?
7. What are the most important issues that a Code could address (any gaps in current regulations)?
8. Most appropriate model for CMEF: Principles-based or Code of Conduct?

V. *APPENDIX 5: Description of CAF Survey*

The CAF Andean Code of Corporate Governance is a voluntary code of best practices aimed at improving corporate governance practices among regional businesses. In order to assist companies in complying with the code, CAF created a computer-based compliance survey composed of 51 questions divided into 5 sections. In order to account for the varying importance placed on certain Code components, the questions were assigned weights. The company is awarded points according to their answers (Yes = full score, In Progress = 1/2, No = 0, Not Applicable = full score. At the end of each of the five sections, a score is tallied and a title (such as “optimal compliance,” “notable compliance” or “very insufficient”) is assigned.

After completing all 5 sections, a total score is computed and the company is notified that it is X% in compliance. Graphical representations of the company’s progress toward compliance in various areas help give focus to the company’s future efforts. In addition, the company may choose from multiple tools aimed at assisting the company in addressing priority areas. Since the survey tool operates on software downloaded from the CAF site onto a local computer, the results of the survey are never reported. The purpose of the survey is wholly internal – not for external monitoring purposes. The survey may be run at multiple occasions and companies can track their progress at attaining full compliance.

ENDNOTES

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- ³¹ In the case that a non-response was accompanied by a comment which suggested that the question was important, it was not counted as a "non response".